No. [redacted]

# In the Supreme Court of the United States.

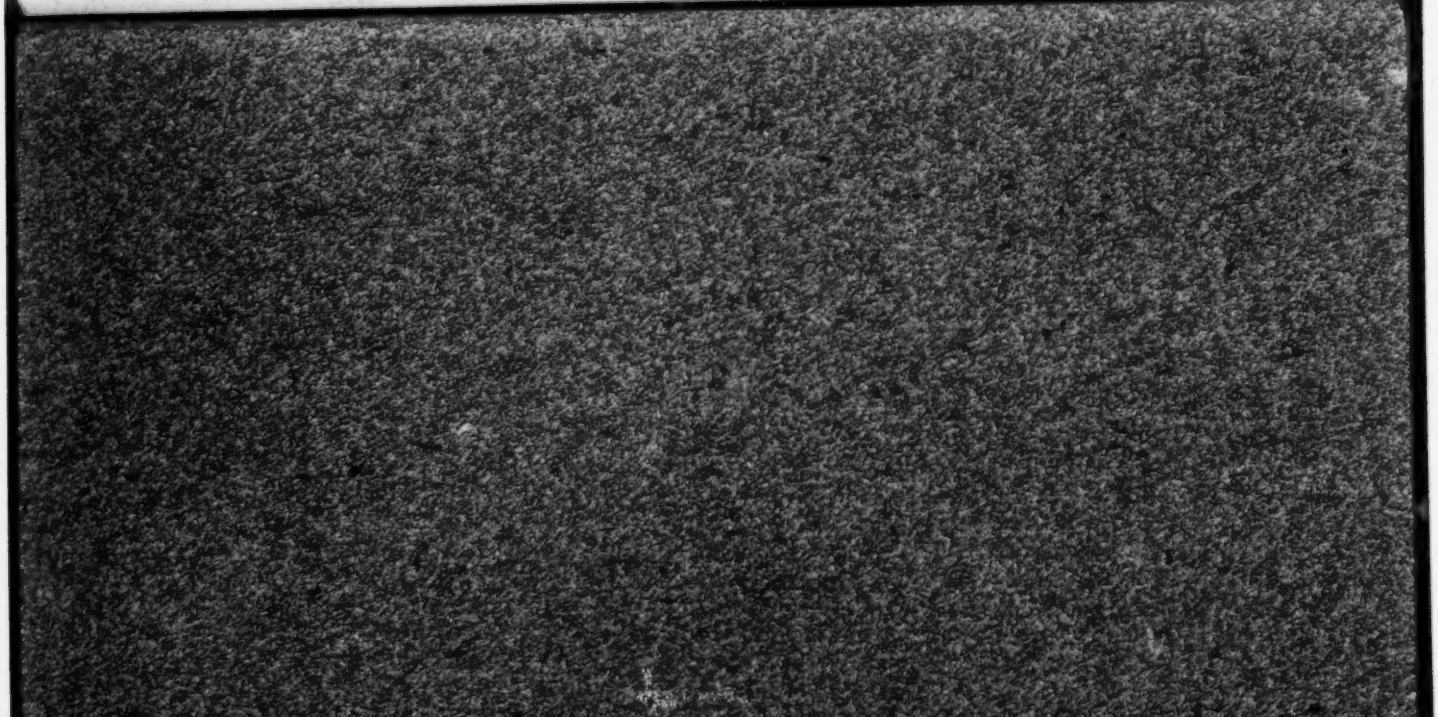
October Term, [redacted] 1922

[redacted], Collector of Internal Revenue, for the First District of Pennsylvania, Petitioner,

vs.

Alexander J. Stoneton, Trustee, Under the Will of Alexander J. [redacted], [redacted].

PETITION FOR WRIT OF CERTIORARI TO THE SUPREME COURT OF THE STATE OF [redacted] AND BRIEF IN SUPPORT.



# In the Supreme Court of the United States.

OCTOBER TERM, 1920.

EPHRAIM LEDERER, COLLECTOR OF INTERNAL REVENUE for the first district of Pennsylvania, petitioner,

*v.*

ALEXANDER D. STOCKTON, TRUSTEE UNDER the will of Alexander J. Derbyshire.

No. —.

**PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT AND BRIEF IN SUPPORT.**

The Solicitor General, on behalf of Ephraim Lederer, collector of internal revenue for the first district of Pennsylvania, prays that a writ of certiorari be issued to review the judgment of the Circuit Court of Appeals for the Third Circuit, rendered in the above entitled cause July 12, 1920, affirming a judgment rendered by the District Court.

**STATEMENT.**

This is an action brought by respondent to recover taxes paid under protest for the years 1913, 1914, 1915, 1916, and 1917. The taxes in question were all assessed upon the income of an estate in the hands of the respondent as executor and trustee. The

taxes for 1913, 1914, and 1915 were assessed under the revenue act of October 3, 1913 (38 Stat., ch. 16, p. 172); those for 1916 under the act of September 8, 1916 (39 Stat., ch. 463, p. 756); and those for 1917 under the act of October 3, 1917 (40 Stat., ch. 63, p. 300). The District Court rendered a judgment for the full amount claimed and the Circuit Court of Appeals has affirmed that judgment.

### THE FACTS.

The respondent is executor and trustee under the will of Alexander J. Derbyshire, who died in 1879. The will made a number of specific bequests and devises and then provided that certain annuities should be paid to three or four different parties during their lives. The executors were then directed—

> to convey, assign, transfer, set over, and pay unto the contributors to the Pennsylvania Hospital, their successors and assigns, for the charitable uses of the said institution, all the rest, residue, and remainder of my estate, real and personal, and of the income, rents, issues, profits, and accumulations thereof which may remain in the hands of my said executors unsold or undisposed of, as aforesaid, after the decease of the annuitants.

During the years in question one of the annuitants was still living, the others having previously died. The income of the estate was very largely in excess of the amount necessary to pay the remaining annuity. The Supreme Court of Pennsylvania, upon an application to have the surplus of income paid

over to the hospital, had held that the residuary devise to the hospital was valid, but that, under the terms of the will, no part of it could be paid over or received until after the death of the last of the annuitants. After this ruling the surplus income each year was loaned to the hospital on a mortgage. It might be inferred from the language of the opinion of the Court of Appeals that the corpus of the estate was loaned to the corporation and that all the income which the trustee collected was a sufficient amount of interest paid by the hospital to defray the expenses of administration and pay the annuity. This obviously, however, is not what the court meant, for it is clear from the record that the trustee retained in his hands the corpus, collected the income, and loaned the latter to the hospital (Rec., p. 41). The trustee, therefore, was receiving an income upon the estate, the surplus of which he was holding for distribution or payment to the hospital under the terms of the will upon the death of the last annuitant.

### QUESTION INVOLVED.

The claim is, that this income collected by the trustee was exempt from taxes because so much of it as should not be needed for the purposes of the estate and for paying the annuity would ultimately go to a charitable institution.

## STATUTES INVOLVED.

The act of 1913 levies a tax upon the net income of individuals, and section II D of that act is as follows (38 Stat., c. 16, p. 168):

> * * * guardians, trustees, executors, administrators, agents, receivers, conservators, and all persons, corporations, or associations acting in any fiduciary capacity, shall make and render a return of the net income of the person for whom they act, subject to this tax, coming into their custody or control and management, and be subject to all the provisions of this section which apply to individuals.

Subsection G(a) of the same section provides that nothing in that section shall apply, among other things, to any corporation or association or benefit organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual. The revenue act of 1916, section 2(b), provides:

> Income received by estates of deceased persons during the period of administration or settlement of the estate shall be subject to the normal and additional tax and taxed to their estates, and also such income of estates or any kind of property held in trust, including such income accumulated in trust for the benefit of unborn or unascertained persons, or persons with contingent interests, and income held for future distribution under the terms of the will or trust shall be likewise taxed, the

> tax in each instance, except when the income is returned for the purpose of the tax by the beneficiary, to be assessed to the executor, administrator, or trustee, as the case may be. (39 Stat., ch. 463, p. 757.)

And section 11(a) of the same act provides that there shall not be taxed under this title any income received by any corporation or association organized and operated exclusively for religious, charitable, scientific, or educational purposes, no part of the net income of which inures to the benefit of any private stockholder or individual.

The provisions of the act of 1917 are practically the same as those of the act of 1916. (40 Stat., ch. 63, pp. 300, 329, 331.)

### RULING OF THE COURT BELOW.

The Circuit Court of Appeals held that, to all intents and purposes, the income taxed was the income of a corporation organized exclusively for charitable purposes, and hence was exempt under all the acts referred to.

### JUDGMENT OF THE COURT BELOW ERRONEOUS.

The income which was taxed in this case was the income arising from the estate of a deceased person in the hands of his executor and trustee. It was received during the taxable years by the executor and trustee. It was clearly subject to tax, therefore, unless it can be said to have been also the income of the charitable organization in question. Under the act of 1913, as quoted above, there was a general pro-

vision requiring all persons and corporations acting in any fiduciary capacity to render a return of the income, trust, or estate for whom they act, trustees, executors, and administrators being expressly included in such persons and corporations. It is then provided that nothing in that section shall apply to charitable corporations, the obvious meaning being that such charitable organizations should not be required to make returns. It would seem that income received by trustees and executors of deceased persons was intended to be treated as the income of the estate and not of the persons to whom it might ultimately go and, hence, that it should be taxed in the hands of the trustee. Certainly more can not fairly be claimed than that if any part of the income of the estate is paid under the terms of the will to a charitable organization as it accrues, that much of the income, but no more, shall be exempt. In the present case the estate was to be kept intact until the death of certain annuitants. So long as any one of these annuitants lived, no part of the income could be used for any purpose except payment of the annuity and the expenses of administration. No part of this income was required to be paid to the hospital in question. Indeed, the Supreme Court of Pennsylvania decided that it could not lawfully be so paid. Whatever portion of the income, therefore, was not used in the payment of annuities and expenses of administration was simply added to the corpus of the estate. At no time would the trustee ever have the right to hold the

estate and collect income to be paid over to the hospital. The moment the last annuitant should die it would be the duty of the trustee to assign the whole of the estate, including accumulations added from year to year, to the hospital. A part of what the hospital would thus receive would, of course, be income which the trustee had previously received from the estate. It would, however, be received by the hospital not as income but as a part of the corpus of the estate to which, upon the death of the annuitant, it would become entitled. In the present case, so small a part of the income was required for the payment of annuities that the accretions added to the corpus each year were large, and enhanced the amount of the estate which the corporation would finally receive as residuary legatee. But if it be held that, because of this fact, the income thus added to the corpus is exempt, a principle will be established which is not only erroneous, but would greatly embarrass the administration of tax laws. Wills by which estates are required to be held intact and the income used for specified purposes during the lives of certain persons, and thereafter the estate to go to charitable organizations, are rather common. In cases in which the entire income is required to be used for specified purposes no one would doubt that such income was taxable, although the corpus of the estate would finally go for a charitable purpose.

In cases like the present, however, where only fixed amounts of the income are to be used during the lives of the annuitants, there is a balance of income which

naturally is added to the corpus and which may, or may not, according to exigencies which may arise, finally go to the charitable organization as a part of the estate. When collected, however, it was the income of the estate which the trustee, representing the estate, could invest for the purpose of increasing the corpus. The charitable organization not being entitled to receive it as income, it certainly can not be said that the tax has been levied on the income of such an organization. In other words, the act of 1913 has not been made to apply in any sense to a corporation to which the act provides it shall not apply. The act of 1916 is even more specific. It contains a provision applying to income received by estates of deceased persons and prescribes expressly that such income shall be taxed when it is held "for future distribution under the terms of the will or trust." Certainly the unexpended income for each of the years in question in this case was held for future distribution and was taxable, unless it comes within the provision as to incomes "received" by charitable organizations. But this income was not received by the hospital, could never be received by it as income, and would go to it ultimately as a part of the estate only in the event it should not be needed for any of the purposes of the will. In the meantime, as income, it could be nothing except the income of the estate held for future distribution or disposition.

The judgment below is clearly erroneous, unless the law is that every part of the income of an estat

which will or may become a part of the fund, which, under the terms of the will, ultimately goes to a charitable institution, must be deducted from the taxable income of the estate. It is of importance to the Government that the question be settled, since the rule announced by the court below would lead to great confusion with respect to the taxes collected and to be collected under the acts of 1913 and 1916 from estates in which similar provisions have been made for the residuum of estates.

**IMPORTANCE OF THE QUESTION AS BEARING UPON THE REVENUE ACT OF 1919.**

The question is of still greater importance because it will necessarily arise under the act of February 24, 1919 (40 Stat., ch. 18, p. 1071). Section 219 (b) of that act allows as a deduction for income tax purposes "any part of the gross income which, pursuant to the terms of the will or deed creating the trust, is during the taxable year paid to or permanently set aside for" any charitable organization. The clear meaning of this act is that no part of the income of an estate shall be exempt, unless it is actually paid to the charitable organization or, at least, set aside from the balance of the estate for the purposes of such an institution. And yet, if the judgment of the court below is correct, it would follow that the mere failure to use a part of the income, with the result that it is added to the estate, is to be regarded as equivalent to a receiving of that income by the charitable organization. It is, therefore, a matter of general importance to the Government in order that it may be relieved from

embarrassment with respect to the taxes collected under the acts of 1913 and 1916, as well as those to be collected under the act of 1919, that the erroneous judgment of the court below be reversed.

## CONCLUSION.

It is respectfully submitted that the writ of certiorari should be issued as prayed.

WILLIAM L. FRIERSON,
*Solicitor General.*

SEPTEMBER, 1920.

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